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Promoting responsible electronics supply chains through public procurement

Olga Martin-Ortega, Opi Outhwaite and William Rook

The School of Law, University of Greenwich

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Executive summary

- The electronics industry supply chain is particularly complex, with many companies involved in the manufacturing process and most of them far removed from the end user. Events involving well-known electronics brands have highlighted the exploitative and unsafe conditions under which many workers in the supply chain operate.
- Public procurement contracts worldwide are estimated to be worth one-thousand-billion euros annually and account for 16 per cent of GDP in the European Union. Because of their considerable buying power, public authorities, through their public procurement contracts, hold the potential for significant leverage in social and sustainability issues.
- Within the European Union, public procurement contracts are subject to EU rules which aim to ensure non-discrimination and transparency in the procurement process. These rules also determine the extent to which social considerations are permitted within the procurement process.
- The best opportunity to introduce social considerations is within the contract performance stage of the process, which allows the buyer to specify the conditions to be performed once the contract has been granted.
- Developing contract performance conditions which apply throughout the supply chain is challenging for several reasons. Two approaches to using such conditions are available: the use of cascading contract conditions and a contractor-led due diligence approach.
- The due diligence approach is suggested as a preferable option since it is less onerous in overall terms, is a responsive model and therefore may be better suited to addressing supply chain problems. It is also more practicable from a contractual perspective.
- The necessary features of an effective contract performance condition include requirements for the disclosure of factory locations, determination of labour conditions and standards to be required, provision for access to factories and monitoring and for remediation and the imposition of penalties.



Introduction

This policy paper presents work undertaken in the Business, Human Rights and the Environment (BHRE) Research Group on public procurement and the electronics industry supply chain.ⁱ The work was initiated as part of the development of the Electronics Watch initiative and was supported by funding from the University of Greenwich (RAEF-HSS-06/13)ⁱⁱ.

The aim of the work summarised in this paper was to find ways to address the poor labour conditions and human rights violations occurring within the electronics industry supply chain. This paper focuses on the potential for public procurement contracts to be used as a tool to improve conditions for workers in the global electronics supply chain. First, in-depth doctrinal analysis of existing and newly adopted rules EU legislative rules on public procurement was undertaken to identify the extent to which social considerations generally were permitted and the extent to which such considerations could be applied in a supply chain context. Second, building on this analysis, options for the development of legal mechanisms through which supply chain conditions could be influenced were explored. Two main possibilities were considered and are discussed in this paper; (i) the use of cascading contract conditions and (ii) a contracted supplier-led due diligence approach. There are strengths and limitations to each approach but the contracted supplier-led due diligence approach is considered to offer the best opportunity to influence conditions through the supply chain without introducing overly onerous, impractical or unenforceable obligations on the respective parties. Finally, suggestions are made as to how such an approach might be realised in practice.

Public procurement and labour conditions in the electronics supply chain

In common with other sectors operating in international markets the production of electronic goods often takes place in the context of a multi-tiered global supply chain. A single product may contain work carried out by several companies in multiple countries. The lead firm or 'brand' frequently carries out little or no manufacturing or production itself and contracted suppliers (or 'contract manufacturers') are instead used by the brand. These suppliers may be large enterprises with many employees operating in multiple locations. These companies assemble the products and may purchase components and assemble parts of the final product such as circuit boards. This structure makes it difficult to require or verify standards throughout the supply chain since the lead firm is typically not in a contractual relationship with the employees of its suppliers or with subcontractors nor in turn do those suppliers assume equivalent responsibilities in relation to their own subcontractors.

Pressures including the desire to introduce new products to market in a short-time frame have been associated with problems of poor labour conditions and human rights violations. Issues reported include the use of flexible and migrant labour, insecure employment terms, poor standards of accommodation for workers, unsafe working environments, strict rules enforced through punitive sanctions, discriminatory employment practices, barriers to free association, and inadequate wages.

Public procurement offers a potentially valuable contribution to the search for strategies to improve working conditions in the electronics supply chain by potentially creating market demand for responsibly manufactured goods. Electronic goods comprise a significant portion of public purchases, are often high value items and are procured in high volumes. Public procurement contracts worldwide are estimated to be worth one-thousand-billion euros annually and account for 16 per cent of GDP in the European Union.ⁱⁱⁱ Given the buying power associated with public procurement contracts they also hold the potential for significant leverage in social and sustainability issues.

Social considerations in EU public procurement rules

Within the European Union the public procurement process is subject to rules set out in EU Directives. These rules are now found Directive 2014/24/EU. This new Directive was adopted in April 2014 and replaced the public

procurement regime established in Directive 2004/18. Member States must implement the new rules by April 2016. Additionally, in the framework of the EU, all public sector authorities, whatever the procurement, are subject to the Treaty on the Functioning of the European Union, most significantly in relation to rules on equal treatment, freedom of establishment, and freedom to provide services. This means that at the very least contracting entities must act transparently and must treat all bidding parties equally, proportionately and without discrimination. To exploit the potential for public procurement to play a role in reforming the electronics industry supply chain, a crucial issue is the extent to which the new Directive allows social considerations to be included in the procurement process, within these rules.

Stages of procurement

There are three main phases in which social considerations can potentially be introduced in the procurement process:

- (i) the use of technical specifications, which establish the required characteristics of the product or service tendered for,
- (ii) award criteria, which allow the public buyer to make comparisons between tenders and can be weighted, with points awarded based on the ability of the tenderer to meet each of the specified criteria, and
- (iii) contract performance conditions, which can be used to establish conditions that must be performed by the successful tenderer once the contract has been awarded.

The first two phases apply before a contract has been awarded and the third applies after the award.

Pre-award stages

In the case of technical specification, the definition of this term, within the EU procurement rules, does not explicitly recognise general social considerations nor does it make reference to minimum labour standards or other considerations relevant to the supply chain. Only a limited reference to social considerations is included, establishing that whenever possible technical specifications should be defined so as to take into account accessibility criteria for people with disability or design for all users. The new Directive does extend the potential for labelling requirements to include the use of social labels (as opposed to only eco-labels in the previous rule) but only the parts of the label that are linked 'to the subject-matter of the contract and are appropriate to define characteristics of this subject-matter' may be included. This is unlikely to extend to labour conditions of employees in sub-contracting factories that assemble components, for instance.

Similarly, in the case of award criteria, a slightly more permissive approach is adopted in the new Directive, with the Recitals making reference to social considerations and the 'whole life cycle' of the product, in the context of award criteria. Instead of a requirement for the contract to be awarded on the basis of 'lowest price', the new Directive refers to the most 'economically advantageous tender'. The decision as which tender meets this threshold may consider the best price-quality ratio, which shall be based on criteria including 'qualitative, environmental and/or social aspects, linked to the subject-matter of the public contract in question...' (Article 67). Nevertheless, the Directive makes clear that award criteria cannot be used to impose general requirements for corporate social responsibility and must be linked with the subject matter of the contract. Criteria and conditions relating to general corporate policy, which cannot be considered as a factor characterising the specific process of production or provision of the purchased works, supplies or services, are expressly excluded as linking with the subject-matter for these purposes. Other references to working conditions appear focused on the domestic employment policies of Member States.

Directive 2014/24 has in some respects increased opportunities to include social considerations in the public procurement process. There remain however, considerable restrictions particularly with respect to social considerations that would extend to supply chain issues, rather than pursuing narrower domestic policies (for instance concerning social inclusion and employment practices).^{iv} The sometimes vague and at the same time limited reference to social considerations and the required subject-matter linkage, the restrictions on application to the supply chain and the need to ensure that the pre-award phase of the process does not interfere with non-discrimination rules, mean that the opportunities in technical specifications and the award criteria phase are particularly limited. The best opportunity to incorporate social consideration lies with the contract performance phase.

Contract performance conditions

Contract performance conditions apply after the contract has been awarded and so do not impact on the assessment of tenders. These conditions relate to the execution of the contract, rather than forming the basis of the award, and it is not necessary for tenderers to demonstrate compliance prior to the award of the contract.

The new Directive provides a slightly broader basis for the inclusion of social considerations in contract performance conditions compared with Directive 2004/18. The conditions may include 'economic, innovation-related, environmental, social or employment-related considerations' where related to the subject-matter of the contract. The basis for inclusion here is termed more broadly than for other phases of the procurement process. In addition, Directive 2014/24 recognises the use of subcontractors in the context of contract performance (unlike in other phases of procurement). It provides that a Member State may ask the contracting authority to indicate any share of the contract that they intend to subcontract and that national authorities may take action to ensure that subcontractors observe the principles of procurement laid out in the Directive. . These include that Member States shall take appropriate measures to ensure 'that in the performance of public contracts economic operators comply with applicable obligations in the fields of environmental, social and labour law established by EU or national law or certain international environmental, social and labour law provisions...'.¹⁵ These include core International Labour Organisation Conventions such as those addressing freedom of association, right to organise and collective bargaining; forced and child labour, discrimination and equal pay.

However, there are limitations on the use of social considerations in contract performance conditions too. The main one being the requirement for a link with the subject matter of the contract and an apparent emphasis on domestic (Member State and EU) employment policies. Equally, the measures pertaining to subcontractors are addressed to Member State and do not directly impose requirements on public buyers.

Further challenges of global supply chains

The finding that EU rules enable contract performance conditions to be used to pursue social considerations provides an important starting point but is not, in itself, enough to enable global supply chain issues to be addressed. To usefully do so, any conditions imposed will need to have extraterritorial reach – that is, they must apply outside of the jurisdiction of the contracting public authority – and to apply to the different tiers of the chain.

Extraterritorial reach

Extraterritorial reach is important because the contractors and subcontractors involved in the manufacture and assembly of electronics goods can be found in numerous countries and will often be outside of the EU, particularly in locations such as China, Mexico, Malaysia, and the Philippines. The applicable legal standards that protect workers will also vary and might not be clear to all parties in the chain given that businesses in the supply chain operate in diverse jurisdictions.

Supply chain tiers

Addressing different tiers of the chain is important because of the nature of electronics production which is characterised by complex and often lengthy supply chains which can involve many parties. The factories involved in the chain are often not in a contractual relationship with the public buyer and in some cases also not the contracting supplier. Whilst the public buyer may agree conditions with the contracting supplier, without additional efforts the buyer has no role in ensuring that the desired conditions are adopted by the contracting supplier in their contracts with subcontractors. A public buyer cannot impose requirements on parties with whom it is not in a relationship and nor is it in a position to enforce or monitor conditions further along the supply chain.

The key issue therefore becomes how, on the basis of contract performance conditions, to overcome these limitations to ensure that the desired standards or outcomes are incorporated along the supply chain.

Two suggested approaches

The research carried out by the BHRE Research Group considered two options for the use of contract performance conditions (i) the use of contract terms throughout the supply chain and (ii) a due diligence approach which places emphasis on the role of the contracting supplier.

Cascading contracts

The first approach is that the public buyer could seek to use the procurement process to influence the whole supply chain through the use of 'cascading' contract performance clauses in which suppliers at each level assume responsibilities with regard to working conditions, monitoring and supervision of the supplier with whom they are in a direct contractual relationship. This passes a chain of contract performance conditions down the supply chain. In this approach, the contract between the public buyer and the contracting supplier includes a clause requiring specified conditions to be written into the contracts at every level of the supply chain. In this way the buyer will have determined the conditions to be met by subcontractors further down the chain even though they are not in a contractual relationship with those subcontractors. Failure to ensure that the agreed contract performance criteria were passed on would ultimately result in a failure of the contractor to fulfil their own contract performance conditions, and potentially on a breach of contract.

The approach is attractive insofar as it provides a clear legal, contractual basis for the adoption of desired standards at all levels of the supply chain. At the same time it works around the problems of an absence of direct legal relationships between the public buyer and suppliers further along the chain. It also avoids the possibility of the public buyer having to assume an undesirable and disproportionate degree of responsibility for failures by those suppliers by taking responsibility themselves for ensuring that supply chain conditions are respected. Challenges with the approach stem from the difficulty of varying a large number of ongoing contracts, which would be necessary in order to introduce the clauses. Implementation and enforcement would also be difficult because the relationship between the parties at each level of the chain remains separate.

Contracting supplier responsibility and supply chain due diligence

This approach sees the contracting supplier (the one the public buyer has a direct legal relationship with through the procurement contract) assume the main responsibility for ultimately transforming working conditions in the supply chain. Although this approach could be pursued through the imposition of explicit legal obligations on the supplier to ensure that specified conditions are met by all of the subcontractors in the chain, this imposes significant and inflexible obligations on the supplier. It would also be onerous for the public buyer who would need to follow up on the obligations along the supply chain in order to determine compliance by the contracting supplier.

A preferable means of making the contracting supplier responsible under a procurement contract is to require the supplier to assume an obligation to exercise due diligence over its supply chain. A due diligence approach would be consistent with current international developments regarding management of supply chains including the UN Guiding Principles on Business and Human Rights (2011) and the OECD Guidelines on Multinational Enterprises (2011). In this context businesses are expected to 'base their activities on the exercise of due diligence and have in place the processes and mechanisms to track, monitor and respond to any negative human rights impact their activities create' (UNGP 17).

Applying this to the electronics industry supply chain the contracting supplier would be required by the public buyer in the contract performance conditions to exercise due diligence; this is, to take the necessary steps to identify its own supply chain; monitor it and adopt the necessary measures to avoid abusive working relationships and practices inconsistent with agreed rights and labour conditions, including through independent auditing; report on the measures taken and potentially engage in remediation when conditions have been violated. The approach clearly imposes a substantial duty on the contracting supplier but potentially provides for mitigation and improvement on a responsive basis rather than depending on 'all or nothing' compliance. For the public buyer it

potentially addresses some of the difficulties arising from the chain of contracts and lack of direct legal relations between the various parties along the chain whilst still providing a means to require that agreed conditions and rights are respected.

Inserting supply chain considerations into contract performance conditions

The research considered the particular requirements that would be needed – in either of the two approaches – for contract performance conditions to be used effectively to address supply chain issues in the electronics industry.

Disclosure of suppliers and factory locations

Identification of the factories in the supply chain is a necessary precursor to awareness of the working conditions in those factories but in a simple contract between a public buyer and a supplier there is no legal requirement for the identification of the sub-contractors (and therefore the factories) which the contractor will use to deliver the contracted goods. The difficulties of varying numerous contracts and verifying the implementation of separate contracts at different stages of the chain would apply if the cascading clauses approach were adopted. A due diligence approach would see the contracting supplier take appropriate measures to trace and provide information on the subcontractors and factories that form part of the supply chain for the contracted goods to the public buyer. Although this would place an initial burden on the contracting supplier this could reduce over time for example if contractors began to adopt disclosure requirements in their own contracts.

Determination of working conditions and labour standards

Choices will be needed concerning the standards or working conditions that would be expected within the identified factories. Defining these standards in terms of the general problem — for instance requiring 'fair' wages or 'reasonable' lead times is problematic from a contractual point of view; addressing the working conditions upon which the problems rest, for instance by determining requirements for minimum wages, maximum working hours, and security of employment contracts would be preferable.

The specific standards to apply could be decided by reference to existing standards such as those of the International Labour Organisation (ILO) but these will not necessarily address all concerns associated with the electronics supply chain. The public buyer may then consider it necessary to supplement these with additional standards. Another option is to have the standards determined by an external organisation; this approach has been adopted elsewhere for instance through the Codes of Conduct of the Workers' Rights Consortium and the Fair Labor Association. In the context of the electronics industry, Electronics Watch has elaborated a Code of Labour Standards.

Monitoring and access to factories

To verify that the agreed standards are being met it will be necessary to provide for accessing and monitoring the sites and factories. The main issue is which party assumes the responsibility for such monitoring – a public buyer is unlikely to want to take on this burden given its remit and limited resources. The contracting supplier may not have the means or willingness to undertake such monitoring, and leaving it to each subcontractor raises questions of independence. In this context an independent monitoring organisation may usefully form a part of the process. This again is an approach seen elsewhere, for instance by the Workers' Rights Consortium and the Fair Labor Association and by Electronics Watch, who works alongside workers and local civil-society organisations in investigating electronics manufacturing.

The cascading contract clauses approach finds difficulties here for the same reasons described above. More pragmatically, in the due diligence approach the supplier would assume responsibility for ensuring that all the companies in its supply chain agree to allow access by an independent monitoring organisation. This responsibility would be identified in the contract performance conditions but, in line with the due diligence approach, decisions as to how it is achieved would be made by the contracting supplier. Although this would be a

burden for the contracting supplier in some respects it could also be the case that once a supply chain for a product has been fully reported on and subject to monitoring or auditing this would be a marketable asset to the supplier.

Remediation, penalties and sanctions

An important consideration in this process is the consequences that should flow in the event of non-compliance by any of the parties. Where an independent organisation performs a role in monitoring supply chain factories it is logical that they would report violations of the determined standards to the supplier. The terms and definitions of these violations would need to be clearly specified. In line with current international developments the contracting supplier has a responsibility to mitigate or redress harm, which will imply to take steps to identify and prevent human rights violations or poor working conditions. Furthermore, it should also be required to act when non-compliance and supply chain problems are identified and would therefore assume responsibility for acting in response to reported violations. In the most demanding approach to corporate due diligence, as defined by the UN Guiding Principles, mechanisms for remediation will also be needed; these should ideally provide a means by which all relevant parties, including supply chain employees, sub-contractors, the contracted supplier and the public buyer, can raise issues and seek resolution and remedies.

Recommendations

Public sector buyers should:

- Recognise their potential influence on supply chain conditions based on the buying power of public procurement contracts
- Seek to understand the scope to include social considerations in procurement contracts for public goods
- Consider the adoption of contract performance conditions to address labour standards in the supply chain for electronics goods which they purchase
- Consider joining or affiliating with monitoring organisations such as Electronics Watch to assist in improving and monitoring supply chain conditions; see <http://electronicswatch.org/en/>

Contracting suppliers should:

- Become aware of the supply chains within which they operate
- Understand their own role in the supply chain in relation to the responsibility of business enterprises to respect human rights
- Work with public sector buyers to agree on procurement conditions that will benefit to supply chain workers
- Assess opportunities to adopt and implement due diligence processes that will address supply chain considerations

Researchers and policy makers should:

- Investigate further the legal and policy mechanisms that can support socially responsible public procurement in the electronics industry
- Understand the challenges and opportunities presented in Directive 2014/24/EU in addressing social considerations especially as they relate to global supply chains
- Understand how opportunities to improve supply chain conditions can be realised in practice including through effective implementation, monitoring and remediation strategies

About the BHRE Group

The Business, Human Rights and the Environment Research Group (BHRE) is based at the School of Law, University of Greenwich, UK. The members of the BHRE undertake research on the impact of business activities on the enjoyment of human rights and respect for the environment.

<http://www.gre.ac.uk/bhre>

About the authors

Dr. Olga Martin-Ortega is Reader in Public International Law and leads the BHRE Research Group. She has been researching on business and human rights for over ten years. She has also undertaken extensive research in the areas of post-conflict reconstruction, transitional justice and international criminal law.

Dr. Martin-Ortega is a member of the Board of Trustees of Electronics Watch as well as a member of its Advisory Group. She is founding member and Chair of the European Society of International Law Interest Group on Business and Human Rights and founding member and member of the Executive Committee of the London Transitional Justice Network. She is also a member of the team of Environment Development Consultants-EDC.

Dr. Opi Outhwaite is Senior Lecturer in Law and a member of the BHRE Research Group. Her research spans a number of international law fields with a particular focus on environmental law, human rights and international business. As well as academic research and publications, Opi has a track record of providing research and consultancy for governmental and non- governmental bodies including the UK Department for Environment, Food and Rural Affairs (Defra) and equivalent bodies in Tanzania and Belize. Opi is a member of the Electronics Watch Advisory Group and participates in several networks for international environmental law and business and human rights. She also teaches aspects of Human Rights and Civil Liberties and International Environmental Law.

William Rook is a PhD candidate and a Researcher in the BHRE Research Group. He has a law degree from SOAS, University of London, a Masters in International Relations from the University of Cambridge, and is admitted to practice as a Solicitor. William is a member of the Electronics Watch Advisory Group.

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ⁱ See further, Martin-Ortega, O., Outhwaite, O. and Rook, W. (forthcoming, 2015), “Buying power and human rights in the supply chain: legal options for socially responsible public procurement of electronic goods”, *International Journal of Human Rights*.

ⁱⁱ Electronics Watch is a consortium of NGOs and associated partners which aims to improve working conditions in the global electronics supply chain. See <http://electronicswatch.org/en>.

ⁱⁱⁱ DG Trade, Public Procurement, <http://ec.europa.eu/trade/policy/accessing-markets/public-procurement/>.

^{iv} This restrictive interpretation appears to be supported by a European Commission publication on the issue, see European Commission Public Procurement Reform, Fact Sheet No 8: Social Aspects of the New Rules, available at http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/reform/fact-sheets/fact-sheet-08-social_en.pdf.

^v Art 71(1). The relevant international environmental, social and labour law provisions are listed in Annex 10.

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